
Finance Committee

HB 2368

Brief Description: Concerning the municipal business and occupation tax.

Sponsors: Representative Santos.

Brief Summary of Bill

- Delays the mandate for apportionment of income under municipal business and occupation (B&O) taxes from January 1, 2008 to January 1, 2009.
- Changes the apportionment formula for services income under the municipal B&O taxes.

Hearing Date: 3/5/07

Staff: Rick Peterson (786-7150).

Background:

Forty cities impose business and occupation (B&O) taxes on the gross receipts of activities conducted by businesses without any deduction for costs. The Legislature limited city B&O taxes to a maximum rate of 0.2 percent in 1982, but higher rates are allowed if approved by the voters in the city, or if a higher rate was in effect prior to January 1, 1982. Cities imposing a B&O tax for the first time after April 22, 1983, and cities increasing tax rates, must provide for a referendum procedure to apply to the ordinance imposing or increasing the tax.

In 2003, legislation was enacted that requires the Association of Washington Cities (AWC) to adopt a model ordinance that provides a more uniform system of municipal B&O taxes. All 40 cities imposing B&O tax have adopted the model ordinance. The model ordinance provides for credits and deductions that are designed to prevent the taxation of the same income by more than one city. Cities are prohibited from imposing a B&O tax that does not comply with the model ordinance provisions after 2004.

The 2003 legislation also requires that cities allow for the allocation and apportionment of business income under their gross receipts B&O taxes by January 1, 2008. For activities other than services or income from royalties, income is allocated based on location of the activity. For

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sales of tangible personal property, the location is based on the location of delivery to the buyer. Income from royalties is allocated to the commercial domicile of the taxpayer. Income from services is apportioned based on a combination of the location of the payroll of the employees performing the service and the location of the customer. The allocation and apportionment of business income eliminates, to a large extent, the "throwback" of the income of businesses that operate in B&O cities that is derived from sales that take place in areas where city B&O taxes do not exist. Taxpayers may petition for alternative method of apportionment.

The Department of Revenue (DOR) was asked to estimate the fiscal impact of the allocation and apportionment rules on city B&O revenue. The DOR engaged a tax advisory committee made up of business and city representatives. Their report was issued in November 2005. The revenue losses were estimated at \$23.3 million based on calendar year 2004 activity.

The report also contained a number of options to alleviate negative revenue impacts on the cities. The mitigation options included repealing the allocation and apportionment requirements, providing full and permanent state funded compensation either through existing revenue sources or increasing the state B&O tax, delaying apportionment until a permanent funding source for compensation is available, delaying implementation for two additional years, delaying implementation for cities where impacts are large relative to total city revenues, transferring administration of city B&O taxes to the DOR, or providing mitigation through increased city B&O rate capacity or city sales tax (credited against the state sales tax.) Consensus was not reached on these mitigation options.

Summary of Bill:

Apportionment of municipal business and occupation taxes is delayed from January 1, 2008 to January 1, 2009.

The apportionment formula for services income is changed. The payroll factor is changed to assigning the payroll of employees to the city where the employee's base of operations is located rather than assigning the payroll of employees to the city based on where 50 percent of the employee's activity occurs. The employee's base of operation is the place where the employee starts work and returns to receive instructions from the taxpayer or communications for the customer, or to replenish stock, repair equipment, or to perform other functions necessary to the employee's trade or profession.

The service income factor is changed so that income is assigned to where the service activity is performed rather than where customer is located.

A property factor is added to the apportionment formula for service income. Property owned or rented by the taxpayer and used in the city is assigned to the city. Property in transit is assigned to the destination city. Mobile property is assigned to a city in proportion to the time the property is in the city.

A service taxpayer may choose to not apportion income, instead they may, if located in a B&O city, assign the transaction to the city where they are located or, if not located in a B&O city, assign the transaction to the city where service is rendered.

When a taxpayer uses an alternative method of apportionment, the taxpayer is required to continue to report under the approved method until approval is given to change the method.

Cities may impose a B&O tax that is not in compliance with the model ordinance provisions, however, tax imposed on a taxpayer cannot be higher than a tax that complies with the model ordinance.

When the Legislature changes statutes directly referenced by the model ordinance then the statutory change supersedes the model ordinance. Tax payments for municipal B&O taxes are not due before the date the state B&O tax is due.

City B&O tax return information may be held confidential by the city and is exempt from public inspection. The information may be disclosed under the same rules as DOR tax information.

Appropriation: None.

Fiscal Note: Requested on February 28, 2007.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.